

FINANCIAL AUDIT
OF THE
INFORMATION TECHNOLOGY REVOLVING FUND

DEPARTMENT OF MANAGEMENT AND BUDGET

October 1, 1994 through September 30, 1996

EXECUTIVE DIGEST

INFORMATION TECHNOLOGY REVOLVING FUND

INTRODUCTION	This report contains the results of our financial audit* of the Information Technology Revolving Fund (Fund) administered by the Department of Management and Budget for the period October 1, 1994 through September 30, 1996.
AUDIT PURPOSE	This financial audit of the Fund was conducted as part of the constitutional responsibility of the Office of the Auditor General. Financial audits are conducted at various intervals to permit the Auditor General to express an opinion on the State's financial statements. Also, this audit complements the departmentwide financial audit.
BACKGROUND	The Fund was created from the Telecommunications Revolving Fund effective October 1, 1992. The Fund was established to account for various services provided by the Fund to all State agencies. These services include various items, such as telecommunications, data processing, customer service, and administration of master contracts. The cost of providing these services is charged to the user agencies on a monthly basis.

* See glossary on page 29 for definition.

As of September 30, 1996, the Fund had 191 full-time employees. The Fund had operating expenses of \$53,153,008, operating revenues of \$51,519,844, and net losses of \$1,716,475 for fiscal year 1995-96.

**AUDIT OBJECTIVES
AND CONCLUSIONS**

Audit Objective: To assess the adequacy of the Fund's internal control structure* .

Conclusion: Our assessment of the Fund's internal control structure did not disclose any material weaknesses*. However, we noted reportable conditions* related to fixed asset depreciation and the Fund's cash flows (Findings 1 and 2).

The departmentwide financial audit, including provisions of the Single Audit Act, for the period October 1, 1994 through September 30, 1996 reported two reportable conditions related to the internal control structure of the Department of Management and Budget that are applicable to the Fund's audit. Those findings related to incompatible user classes in the Michigan Administrative Information Network and cash receipting procedures. The findings are not repeated in this audit report.

Audit Objective: To assess the Fund's compliance with State laws and regulations that could have a material effect on the Fund's financial statements.

Conclusion: Our assessment of the Fund's compliance with laws and regulations did not disclose any instances of noncompliance that could have a material effect on the Fund's financial statements.

* See glossary on page 29 for definition.

Audit Objective: To audit the Fund's financial statements for the fiscal years ended September 30, 1996 and September 30, 1995.

Conclusion: We expressed an unqualified opinion on the Fund's financial statements.

AUDIT SCOPE	Our audit scope was to examine the financial and other records of the Information Technology Revolving Fund for the period October 1, 1994 through September 30, 1996. Our audit was conducted in accordance with generally accepted auditing standards and <i>Government Auditing Standards</i> issued by the Comptroller General of the United States and, accordingly, included such tests of the records and such other auditing procedures as we considered necessary in the circumstances.
AGENCY RESPONSES AND PRIOR AUDIT FOLLOW-UP	<p>Our audit report contains 2 findings and 3 recommendations. The agency's preliminary response indicated that the Fund agreed with all 3 recommendations, has complied with 1 recommendation, and will comply with the other recommendations.</p> <p>The Fund complied with 4 of the 9 prior audit recommendations included within the scope of our current audit. The remaining 5 recommendations were no longer applicable to the Fund.</p>

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Ms. Janet E. Phipps, Director
Department of Management and Budget
Lewis Cass Building
Lansing, Michigan

Dear Ms. Phipps:

This is our report on the financial audit of the Information Technology Revolving Fund, Department of Management and Budget, for the period October 1, 1994 through September 30, 1996.

This report contains our executive digest; description of agency; audit objectives, audit scope, and agency responses and prior audit follow-up; comments, findings, recommendations, and agency preliminary responses; and independent auditor's reports on the internal control structure, on compliance with laws and regulations, and on the financial statements. This report also contains the Information Technology Revolving Fund's financial statements and notes to financial statements and a glossary of acronyms and terms.

Our comments, findings, and recommendations are organized by audit objective. The agency preliminary responses were taken from the agency's responses subsequent to our audit fieldwork. The *Michigan Compiled Laws* and administrative procedures require that the audited agency develop a formal response within 60 days after release of the audit report.

We appreciate the courtesy and cooperation extended to us during this audit.

Sincerely,

Thomas H. McTavish, C.P.A.
Auditor General

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Description of Agency

The Information Technology Revolving Fund (Fund) evolved from the Telecommunications Revolving Fund established by the Department of Management and Budget effective October 1, 1992. The Telecommunications Revolving Fund's purpose was to account for telecommunication services provided to other State agencies. Executive Orders 1994-15 and 1995-10 ordered the consolidation of the State's telecommunication and data processing services into one agency. The Telecommunications Revolving Fund was renamed the Information Technology Revolving Fund, and additional responsibilities were given to the Fund. These responsibilities include computer services, administration of master contracts, capitalization of the Michigan Administrative Information Network equipment and programs, and other customer service programs related to information technology. Individual divisions were set up within the Fund to administer the various programs and services under its control.

The Office of the Chief Information Officer is primarily responsible for the overall management of the Fund. The Office of Administrative Services, Department of Management and Budget, administers the accounting for the Fund. The individual divisions within the Fund are responsible for the operations, rate setting, and billing of the various services provided to the State agencies.

The user agencies are appropriated money from the General Fund to pay for the services provided by the Fund. The Fund uses interaccount bills to charge for its services and receive payment from user agencies. Equipment is financed through bonds, borrowing from the General Fund, and notes payable.

As of September 30, 1996, the Fund had 191 full-time employees. For fiscal year 1995-96, the Fund had operating expenses of \$53,153,008, operating revenues of \$51,519,844, and net losses of \$1,716,475.

Audit Objectives, Audit Scope, and Agency Responses and Prior Audit Follow-Up

Audit Objectives

Our financial audit of the Information Technology Revolving Fund, Department of Management and Budget, had the following objectives:

1. To assess the adequacy of the Fund's internal control structure.
2. To assess the Fund's compliance with State laws and regulations that could have a material effect on the Fund's financial statements.
3. To audit the Fund's financial statements for the fiscal years ended September 30, 1996 and September 30, 1995.

Audit Scope

Our audit scope was to examine the financial and other records of the Information Technology Revolving Fund for the period October 1, 1994 through September 30, 1996. Our audit was conducted in accordance with generally accepted auditing standards and *Government Auditing Standards* issued by the Comptroller General of the United States and, accordingly, included such tests of the records and such other auditing procedures as we considered necessary in the circumstances.

Agency Responses and Prior Audit Follow-Up

Our audit report contains 2 findings and 3 recommendations. The agency's preliminary response indicated that the Fund agreed with all 3 recommendations, has complied with 1 recommendation, and will comply with the other recommendations.

The agency preliminary response which follows each recommendation in our report was taken from the agency's written comments and oral discussion subsequent to our audit fieldwork. Section 18.1462 of the *Michigan Compiled Laws* and Department of Management and Budget Administrative Guide procedure 1280.02 require the Department of Management and Budget to develop a formal response to our audit findings and recommendations within 60 days after release of the audit report.

The Fund complied with 4 of the 9 prior audit recommendations included within the scope of our current audit. The remaining 5 recommendations were no longer applicable to the Fund.

COMMENTS, FINDINGS, RECOMMENDATIONS, AND AGENCY PRELIMINARY RESPONSES

INTERNAL CONTROL STRUCTURE

COMMENT

Audit Objective: To assess the adequacy of the Information Technology Revolving Fund's (Fund's) internal control structure.

Conclusion: Our assessment of the Fund's internal control structure did not disclose any material weaknesses. However, we noted reportable conditions related to fixed asset depreciation and the Fund's cash flows.

The Department of Management and Budget's departmentwide financial audit, including provisions of the Single Audit Act, for the period October 1, 1994 through September 30, 1996 reported two reportable conditions related to the internal control structure of the Department that are applicable to the Fund's audit. Those findings related to incompatible user classes in the Michigan Administrative Information Network (MAIN) and cash receipting procedures. The findings are not repeated in this audit report.

MAIN is the Statewide financial management system implemented in fiscal year 1994-95. Individual State agencies are not responsible for the design of the Statewide policies and controls of MAIN. However, because MAIN is a Statewide system, which all State agencies are required to use, the internal control structure of each agency, including the Information Technology Revolving Fund, is affected to varying degrees by MAIN.

Because the Fund's internal control structure is affected by this Statewide system, professional auditing standards required our assessment of internal controls in the Fund to include elements reviewed in our financial related audit of MAIN for the period October 1, 1994 through April 30, 1996. That audit reported 29 reportable conditions, including 3 material weaknesses, which are more fully explained in our separately issued report dated August 31, 1996.

FINDING

1. Fixed Asset Depreciation

The Fund did not maintain records that documented when fixed assets were placed into service. Also, the Fund did not correct errors in depreciation calculations for some fixed assets.

We obtained the Fund's depreciation records and randomly selected 21 equipment items for review. We then recalculated accumulated depreciation for the 21 items based on the listed dates of acquisition and found:

- a. For three assets, the amount we calculated for accumulated depreciation did not equal the accumulated depreciation amount recorded on the depreciation schedule. We calculated the depreciation rate being used and multiplied the rate by the period that the asset was held based on the acquisition date on the depreciation records. According to agency personnel, these items were not placed into service immediately upon acquisition and, therefore, were not depreciated during that time. However, the Fund could not provide records that documented when the equipment was placed in service and could not verify that the amount that had been depreciated was correctly stated. Our calculations indicate that accumulated depreciation could be understated by \$169,769.
- b. Depreciation was miscalculated for one asset that was held for approximately three years and split into five assets. All depreciation recorded was allocated to one of the five assets. This asset did not have a new rate calculated. The four other assets were depreciated without taking into consideration the previous three years' use. Our calculations indicate that accumulated depreciation was understated by \$34,128. Depreciation expense was understated by \$11,377 in both fiscal years 1994-95 and 1995-96.
- c. Depreciation was miscalculated for an asset whose useful life was changed from 20 years to 10 years after it was held for 44 months. A new depreciation rate was not calculated but rather the existing depreciation rate was doubled. Our calculations indicate that accumulated depreciation was understated by \$12,759. Depreciation expense was understated by \$4,253 in both fiscal years 1994-95 and 1995-96.

As a result, accumulated depreciation of the assets discussed in items a. through c. was understated by at least \$46,887 and could be understated by as much as \$216,656. This caused the book value of the Fund's assets to be overstated. Accumulated depreciation must be properly computed to ensure correct asset valuation. Depreciation expense was also understated by \$15,630 in both fiscal years 1994-95 and 1995-96.

RECOMMENDATIONS

We recommend that the Fund maintain records that document when fixed assets are placed into service.

We also recommend that the Fund correct any misstatements in depreciation of the applicable fixed assets and calculate proper depreciation rates for future changes in useful lives of assets.

AGENCY PRELIMINARY RESPONSE

The Fund agreed with the recommendations and informed us that it will comply by March 31, 1998. Revised depreciation procedures will be implemented and corrections will be recorded in the current year.

FINDING

2. Fund Cash Flows

The Fund did not manage its operations in an effective manner to limit General Fund borrowings and to ensure that the Fund is self-sufficient.

Our review of the Fund's cash flows disclosed two problems with the management of the cash flows:

- a. The Fund did not ensure that proper authorization was received for the State Building Authority to issue bonds before purchasing \$40 million in equipment. This resulted in the General Fund financing the equipment purchases in fiscal years 1994-95, 1995-96, and 1996-97. The bonds were not issued until August 1997. The General Fund was not able to charge interest to the Fund for the use of General Fund money because internal service funds are not interest bearing accounts in the General Fund's Common Cash Pool. This

resulted in \$40 million that the General Fund was not able to invest and earn interest income of approximately \$2.4 million per year on during that same time period.

- b. The Fund did not set rates to ensure that revenues equaled or exceeded expenses. For the two fiscal years of our audit period, the rates resulted in operating revenues totaling less than the total operating expenses, which include operating costs, administrative costs, and depreciation expenses. The operating losses contributed to the Fund's negative cash flow.

The Fund has been undergoing numerous changes in the last three years, including the consolidation of programs and the addition of new programs. Rates for the individual services offered by the Fund were calculated by each division within the Fund and in various ways. However, some rates were not calculated high enough to cover expenses.

RECOMMENDATION

We recommend that the Fund manage its operations in an effective manner to limit General Fund borrowings and to ensure that the Fund is self-sufficient.

AGENCY PRELIMINARY RESPONSE

The Fund agreed with the recommendation and informed us that it has complied.

The sale of bonds was delayed awaiting legislative approval, but the bonds were issued in August 1997 in the amount of \$38,459,523. The fiscal year 1996-97 and 1997-98 billing rates are calculated to recover all operating expenses. For the initial years (fiscal years 1995-96 and 1994-95), rates were established at 85% of prior fiscal year 1993-94 cost levels of the various data centers that were consolidated to form the Michigan Information Processing Center (MIPC). Since MIPC had no prior operating experience, it was impossible to develop a more reliable billing rate.

COMPLIANCE WITH LAWS AND REGULATIONS

COMMENT

Audit Objective: To assess the Fund's compliance with State laws and regulations that could have a material effect on the Fund's financial statements.

Conclusion: Our assessment of the Fund's compliance with laws and regulations did not disclose any instances of noncompliance that could have a material effect on the Fund's financial statements.

FINANCIAL ACCOUNTING AND REPORTING

COMMENT

Audit Objective: To audit the Fund's financial statements for the fiscal years ended September 30, 1996 and September 30, 1995.

Conclusion: We expressed an unqualified opinion on the Fund's financial statements.

Independent Auditor's Report on
the Internal Control Structure

November 18, 1997

Mr. Mark A. Murray, Director
Department of Management and Budget
Lewis Cass Building
Lansing, Michigan

Dear Mr. Murray:

We have audited the financial statements of the Information Technology Revolving Fund, Department of Management and Budget, as of and for the fiscal years ended September 30, 1996 and September 30, 1995 and have issued our report thereon dated November 18, 1997.

We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

The management of the Information Technology Revolving Fund and the management of the Department of Management and Budget are responsible for establishing and maintaining an internal control structure, which operates in conjunction with the Statewide internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projections of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of

changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

In planning and performing our audit of the financial statements for the fiscal years ended September 30, 1996 and September 30, 1995, we obtained an understanding of the Information Technology Revolving Fund's internal control structure and internal control elements reviewed as part of our financial related audit of the Michigan Administrative Information Network. The Michigan Administrative Information Network is the Statewide financial management system implemented in fiscal year 1994-95 and, as such, affects the Information Technology Revolving Fund's internal control structure. With respect to the internal control structure, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation, and we assessed control risk in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control structure. Accordingly, we do not express such an opinion.

We noted certain matters involving the internal control structure and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the Information Technology Revolving Fund's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. The reportable conditions are more fully described in Findings 1 and 2.

Also, our financial related audit of the Michigan Administrative Information Network for the period October 1, 1994 through April 30, 1996 noted 29 reportable conditions on the internal control structure which are more fully explained in our separately issued report on the Michigan Administrative Information Network dated August 31, 1996. Although the Information Technology Revolving Fund, Department of Management and Budget, is not responsible for the design of the Statewide policies and controls of the Michigan Administrative Information Network, which all State agencies are required to use, these reportable conditions affected the Information Technology Revolving Fund's internal control structure.

A material weakness is a reportable condition in which the design or operation of one or more of the specific internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be reportable conditions and,

accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. However, we believe none of the Information Technology Revolving Fund's reportable conditions described above is a material weakness. Three of the 29 reportable conditions identified in our financial related audit of the Michigan Administrative Information Network were material weaknesses. These conditions were considered in determining the nature, timing, and extent of the procedures performed in our audit of the financial statements for the fiscal years ended September 30, 1996 and September 30, 1995.

Sincerely,

Thomas H. McTavish, C.P.A.
Auditor General

Independent Auditor's Report on
Compliance With Laws and Regulations

November 18, 1997

Mr. Mark A. Murray, Director
Department of Management and Budget
Lewis Cass Building
Lansing, Michigan

Dear Mr. Murray:

We have audited the financial statements of the Information Technology Revolving Fund, Department of Management and Budget, as of and for the fiscal years ended September 30, 1996 and September 30, 1995 and have issued our report thereon dated November 18, 1997.

We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

Compliance with laws, regulations, contracts, and grants applicable to the Information Technology Revolving Fund is the responsibility of the Information Technology Revolving Fund and the Department of Management and Budget management. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of the Fund's compliance with certain provisions of laws, regulations, contracts, and grants. However, the objective of our audit of the financial statements was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Sincerely,

Thomas H. McTavish, C.P.A.
Auditor General

Independent Auditor's Report on
the Financial Statements

November 18, 1997

Mr. Mark A. Murray, Director
Department of Management and Budget
Lewis Cass Building
Lansing, Michigan

Dear Mr. Murray:

We have audited the accompanying balance sheet of the Information Technology Revolving Fund, Department of Management and Budget, as of September 30, 1996 and September 30, 1995 and the related statement of revenues, expenses, and changes in retained earnings and statement of cash flows for the fiscal years then ended. These financial statements are the responsibility of the Information Technology Revolving Fund management and the Department of Management and Budget management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1b, the accompanying financial statements present only the Information Technology Revolving Fund and are not intended to present fairly the financial position and result of operations of the State of Michigan or its internal service funds.

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the Information Technology Revolving Fund as of September 30, 1996 and September 30, 1995 and the results of its operations and cash flows for the fiscal years then ended on the basis of accounting described in Note 1b.

In accordance with *Government Auditing Standards*, we have also issued a report dated November 18, 1997 on our consideration of the Information Technology Revolving Fund's internal control structure and a report dated November 18, 1997 on its compliance with laws and regulations.

Sincerely,

Thomas H. McTavish, C.P.A.
Auditor General

INFORMATION TECHNOLOGY REVOLVING FUND

Department of Management and Budget

Balance Sheet

As of September 30

	<u>1996</u>	<u>1995</u>
ASSETS		
Current Assets:		
Amounts due from local units	\$ 3,220	\$ 254,984
Other current assets	8	1,505
Total Current Assets	<u>\$ 3,229</u>	<u>\$ 256,489</u>
Property, Plant, and Equipment (Note 4):		
Buildings and equipment	\$ 95,820,109	\$ 40,704,587
Allowance for depreciation	(24,260,543)	16,269,519)
Total Property, Plant, and Equipment	<u>\$ 71,559,566</u>	<u>\$ 24,435,068</u>
Total Assets	<u><u>\$ 71,562,795</u></u>	<u><u>\$ 24,691,557</u></u>
LIABILITIES AND FUND EQUITY		
Current Liabilities (Note 5):		
Warrants outstanding	\$ 392,350	\$ 1,126,015
Accounts payable and other liabilities	9,964,850	5,251,939
Amounts due to other funds	39,124,949	865,264
Total Current Liabilities	<u>\$ 49,482,149</u>	<u>\$ 7,243,217</u>
Long-Term Liabilities (Note 5):		
Advances from other funds	\$ 21,810,235	\$ 17,000,000
Other long-term liabilities	2,208,055	669,508
Total Long-Term Liabilities	<u>\$ 24,018,290</u>	<u>\$ 17,669,508</u>
Total Liabilities	\$ 73,500,438	\$ 24,912,725
Fund Equity:		
Retained Earnings - Unreserved	<u>(1,937,644)</u>	<u>(221,168)</u>
Total Liabilities and Fund Equity	<u><u>\$ 71,562,795</u></u>	<u><u>\$ 24,691,557</u></u>

INFORMATION TECHNOLOGY REVOLVING FUND
Department of Management and Budget
Statement of Revenues, Expenses, and Changes in Retained Earnings
Fiscal Years Ended September 30

	<u>1996</u>	<u>1995</u>
OPERATING REVENUES	\$ 51,519,844	\$ 26,408,682
OPERATING EXPENSES		
Salaries and wages	\$ 36,016,261	\$ 21,397,180
Other administrative expenses	9,145,723	4,523,434
Depreciation	7,991,024	2,258,259
Total Operating Expenses	\$ 53,153,008	\$ 28,178,873
Operating Income (Loss)	\$ (1,633,164)	\$ (1,770,191)
NONOPERATING REVENUES (EXPENSES)		
Interest expense	(47,493)	(36,944)
Income (Loss) Before Operating Transfers	\$ (1,680,657)	\$ (1,807,135)
OPERATING TRANSFERS:		
Operating transfers to other funds	\$ (35,818)	\$ (34,700)
Net Income (Loss)	\$ (1,716,475)	\$ (1,841,835)
Retained Earnings - Beginning of fiscal year	(221,168)	1,620,667
Retained Earnings - End of fiscal year	\$ (1,937,644)	\$ (221,168)

INFORMATION TECHNOLOGY REVOLVING FUND

Department of Management and Budget

Statement of Cash Flows

Fiscal Years Ended September 30

	<u>1996</u>	<u>1995</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Operating income (loss)	\$ (1,633,164)	\$ (1,770,191)
Adjustments to reconcile operating income with net cash provided (used) by operating activities:		
Depreciation	7,991,024	2,258,259
Changes in assets and liabilities:		
Other assets	253,260	(5,982)
Amounts due to other funds		66,651
Accounts payable and other liabilities	6,251,459	4,769,465
Deferred revenue		(112,024)
Net cash provided (used) by operating activities	<u>\$ 12,862,579</u>	<u>\$ 5,206,177</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Loans from other funds	\$ 43,069,919	\$ 10,506,595
Operating transfers to other funds	(35,818)	(34,700)
Net cash provided (used) by noncapital financing activities	<u>\$ 43,034,101</u>	<u>\$ 10,471,895</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Acquisition and construction of capital assets	\$ (55,115,522)	\$ (15,726,935)
Capital lease payments (including imputed interest expense)	(47,493)	(245,238)
Net cash provided (used) by capital and related financing activities	<u>\$ (55,163,015)</u>	<u>\$ (15,972,173)</u>
Net cash provided (used) - all activities	\$ 733,665	\$ (294,101)
Cash and cash equivalents at the beginning of the year	(1,126,015)	(831,914)
Cash and cash equivalents at the end of the year	<u>\$ (392,350)</u>	<u>\$ (1,126,015)</u>

Notes to Financial Statements

Note 1 Significant Accounting Policies

a. Reporting Entity

The accompanying financial statements report the financial position and results of operation of the Information Technology Revolving Fund, Department of Management and Budget, as of and for the fiscal years ended September 30, 1996 and September 30, 1995. This Fund is a part of the State of Michigan's reporting entity and is reported as an internal service fund in the *State of Michigan Comprehensive Annual Financial Report (SOMCAFR)*. The Office of the Chief Information Officer is primarily responsible for the Fund. Within the Fund are the following program offices:

Office of Information Technology:

Management and Information Systems

System Planning

Michigan Information Center

Office of Computing and Telecommunications:

Administrative Services Division

Customer Services Division

Master Contracts Division

Michigan Information Processing Center (MIPC)

Telecommunications

Michigan Administrative Information Network (MAIN) Capitalization

The large increases in balances from fiscal year 1994-95 to fiscal year 1995-96 are attributed to the changes in the number of programs and services offered by the Fund as a result of an executive order. The order brought in master contracts, customer service, the full Consolidated Network Operations Center operation, capitalization of MAIN costs, and the further development of MIPC with the Bull system being added.

The footnotes accompanying these financial statements relate directly to the Information Technology Revolving Fund. The *SOMCAFR* provides more extensive general disclosures regarding the State's Summary of Significant Accounting Policies, Budgeting and Budgetary Control, Treasurer's Common Cash, and Pension Benefits.

b. Basis of Accounting and Presentation

The financial statements contained in this report are prepared on the accrual basis of accounting. The accrual basis of accounting, which emphasizes the measurement of total financial position and results of operations, is explained in more detail in the *SOMCAFR*.

The accompanying financial statements present only the Information Technology Revolving Fund. Accordingly, they are not intended to present fairly the financial position and results of operations of the State of Michigan or its internal service funds.

c. Interfund Transactions

The Fund periodically bills State departments and agencies for services provided. At fiscal year-end, the accounting records are held open until all interfund billings are processed and cash transfers are retroactively recorded.

Note 2 Retirement

All eligible employees of the Information Technology Revolving Fund are members of the State Employees Retirement System. The Fund makes contributions to the System based on a percentage of payroll costs. The Fund's contributions to the System for fiscal years 1995-96 and 1994-95 were \$1,028,778 and \$529,986, respectively.

Note 3 Statewide Cost Allocation Plan (SWCAP)

Within operating expenses are SWCAP assigned costs, which include the cost of services provided by the Departments of Civil Service, Treasury, and Management and Budget for a variety of central support services, such as accounting, payroll, procurement, human resources, budgeting, employee

relations, real estate, mailing services, records retention, and management information services.

Note 4 Property, Plant, and Equipment

Classification: The following table summarizes, by major class of asset, the recorded costs of fixed assets as of September 30:

<u>Classification</u>	<u>1996</u>	<u>1995</u>
Buildings	\$ 4,636,380	\$ 1,907,882
Equipment	36,359,268	26,659,372
EDP Equipment	54,824,461	12,137,332
Total	\$ 95,820,109	\$ 40,704,587
Allowance for depreciation	(24,260,543)	(16,269,519)
Net Property, Plant, and Equipment	<u>\$ 71,559,566</u>	<u>\$ 24,435,068</u>

Depreciation: Depreciation methods and useful life estimates used for buildings and equipment vary. The estimated service of the respective assets range from 3 to 60 years for buildings and from 2 to 25 years for equipment. Some fixed assets are not capitalized and depreciated if the asset costs are insignificant in comparison to total operating costs.

Note 5 Liabilities

Accounts payable and other liabilities: The liability recorded for accounts payable and other liabilities for the fiscal years ended September 30, 1996 and September 30, 1995 consists of vouchers payable for purchase orders outstanding of \$8.4 million and \$4.7 million, respectively; accounts payable of \$0.5 million and \$0.3 million, respectively; accrued payroll of \$0.6 million and \$0.2 million, respectively; compensated absences of \$50,096 and \$49,761, respectively; and capital leases of \$0.3 million for fiscal year 1995-96.

Amounts due to other funds: The liability recorded for amounts due to other funds for the fiscal years ended September 30, 1996 and September 30, 1995

consists of short-term Common Cash borrowing of \$39.0 million and \$0.8 million, respectively, and borrowing from other funds of \$0.1 million and \$66,651, respectively.

Advances from other funds: The liability recorded for advances from other funds for the fiscal years ended September 30, 1996 and September 30, 1995 consists of long-term Common Cash borrowing of \$21.8 million and \$17.0 million, respectively.

Other long-term liabilities: The liability recorded for other long-term liabilities for the fiscal years ended September 30, 1996 and September 30, 1995 consists of long-term compensated absences of \$1.5 million and \$0.7 million, respectively, and long-term capital leases of \$0.7 million for fiscal year 1995-96.

Note 6 Operating Transfers to Other Funds

The operating transfers to other funds represent the Information Technology Revolving Fund's direct charges for the Department of Civil Service costs.

Note 7 Subsequent Events

In August 1997, the State Building Authority issued bonds to finance computer equipment purchased previously by the Information Technology Revolving Fund. The bonds were issued for \$38,861,000 to finance equipment of \$38,459,523 and issuance costs of \$401,477.

Glossary of Acronyms and Terms

financial audit	An audit that is designed to provide reasonable assurance about whether the financial statements of an audited entity are fairly presented in conformity with generally accepted accounting principles.
Fund	Information Technology Revolving Fund.
internal control structure	The management control environment, accounting system, and control policies and procedures established by management to provide reasonable assurance that resources are safeguarded; that resources are used in compliance with laws and regulations; and that financial transactions are properly accounted for and reported.
MAIN	Michigan Administrative Information Network.
material weakness	A serious reportable condition in which the design or operation of one or more of the specific internal control structure elements (including management controls) does not reduce to a relatively low level the risk that errors or irregularities, in amounts that would be material in relation to the financial statements, would not be prevented or detected.
MIPC	Michigan Information Processing Center.
reportable condition	A matter coming to the auditor's attention that, in his/her judgment, should be communicated because it represents either an opportunity for improvement or a significant deficiency in the design or operation of the internal control structure.

SOMCAFR

State of Michigan Comprehensive Annual Financial Report.

SWCAP

Statewide Cost Allocation Plan.